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City and County of San Francisco

Office of the Controller – City Services Auditor

BOARD OF SUPERVISORS:

**Franchise Fee Audit of
NRG Energy Center
San Francisco LLC**

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**CONTROLLER'S OFFICE
CITY SERVICES AUDITOR**

The City Services Auditor was created within the Controller's Office through an amendment to the City Charter that was approved by voters in November 2003. Under Appendix F to the City Charter, the City Services Auditor has broad authority for:

- Reporting on the level and effectiveness of San Francisco's public services and benchmarking the city to other public agencies and jurisdictions.
- Conducting financial and performance audits of city departments, contractors, and functions to assess efficiency and effectiveness of processes and services.
- Operating a whistleblower hotline and website and investigating reports of waste, fraud, and abuse of city resources.
- Ensuring the financial integrity and improving the overall performance and efficiency of city government.

The audits unit conducts financial audits, attestation engagements, and performance audits. Financial audits address the financial integrity of both city departments and contractors and provide reasonable assurance about whether financial statements are presented fairly in all material aspects in conformity with generally accepted accounting principles. Attestation engagements examine, review, or perform procedures on a broad range of subjects such as internal controls; compliance with requirements of specified laws, regulations, rules, contracts, or grants; and the reliability of performance measures. Performance audits focus primarily on assessment of city services and processes, providing recommendations to improve department operations.

We conduct our audits in accordance with the Government Auditing Standards published by the U.S. Government Accountability Office (GAO). These standards require:

- Independence of audit staff and the audit organization.
- Objectivity of the auditors performing the work.
- Competent staff, including continuing professional education.
- Quality control procedures to provide reasonable assurance of compliance with the auditing standards.

Audit Team: Ben Carlick, Audit Manager



CITY AND COUNTY OF SAN FRANCISCO

OFFICE OF THE CONTROLLER

Ben Rosenfield
Controller

Monique Zmuda
Deputy Controller

November 16, 2009

Board of Supervisors
City and County of San Francisco
City Hall, Room 244
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

President and Members:

The Controller's Office presents its report on the review of the franchise fees NRG Energy Center San Francisco LLC (NRG) paid to the City and County of San Francisco (City) to use City streets to install, construct, maintain, and operate steam pipe conduits. NRG is required to report annual gross receipts and to pay 2 percent of the gross receipts subject to the City's franchise fee. The San Francisco Public Utilities Commission (SFPUC) is responsible for overseeing the franchise, except for certain financial requirements administered by the Controller's Office.

Reporting Period: January 1, 2007, through December 31, 2008

Franchise Fees Paid: \$429,713

Results:

NRG correctly reported its gross receipts and correctly paid its franchise fees to the City on a timely basis. The audit identified some deficiencies in City departments' compliance with relevant code requirements for administering and monitoring the steam franchise ordinance. The SFPUC had not submitted to the Board of Supervisors a required compliance report regarding NRG's steam franchise, and the Controller's Budget and Analysis Division did not routinely check the accuracy of the franchise fees paid.

The responses of the SFPUC, Controller's Budget and Analysis Division, and NRG are attached to the report. The Controller's Office, City Services Auditor will work with the SFPUC and the Controller's Budget and Analysis Division to follow up on the status of the recommendations made in this report.

Respectfully submitted,

Tonia Lediju
Director of Audits

cc: Mayor
Board of Supervisors
Budget Analyst
Civil Grand Jury
Public Library

INTRODUCTION

Audit Authority

The Office of the Controller (Controller) is required under the San Francisco Administrative Code, Chapter 11, Article V, Section 11.44(a) to file a report no less than every two years with the Board of Supervisors analyzing whether a franchisee is complying with the audit, reporting requirements, and payment obligations contained in Chapter 11 and the steam franchise ordinance. In addition, the City and County of San Francisco (City) has the right under the San Francisco Administrative Code, Chapter 11, Article V, Section 11.38 to access the books and records of a franchisee to monitor compliance with Chapter 11 of the Administrative Code, the franchise agreement, or other applicable law. Further, the City Charter provides the Controller, City Services Auditor (CSA), with broad authority to conduct audits. We conducted this audit under these authorities.

Background

NRG Energy Center San Francisco LLC (NRG) holds a steam franchise with the City. NRG is owned by NRG Thermal LLC, a subsidiary of NRG Energy, Inc. The City's steam franchise ordinance¹ allows NRG to install, construct, maintain, and operate underground steam pipe conduits to carry steam and/or steam condensate for heating and other purposes in the streets, alleys, and other public places within the City.

As payment for the franchise, NRG is to remit annually to the City 2 percent of NRG's gross receipts subject to the franchise fee. NRG is required to report gross annual receipts subject to franchise fees based on the ratio of the part of the operating plant assets attributable to steam distribution (franchise assets) to the total investment in its operating plant assets. NRG maintains an asset list to track its operating plant assets at the historical cost of each asset, and to identify each asset as a franchise asset or non-franchise asset.

Under the San Francisco Administrative Code, Section 11.1(i), the San Francisco Public Utilities Commission (SFPUC) is responsible for administering the City's steam franchise, except for certain financial requirements

¹ Ordinance No. 418-75.

administered by the Controller. The Controller's Budget and Analysis Division is responsible for receiving the annual report and collecting the franchise fees.

Scope and Methodology

The purpose of this audit was to determine whether NRG correctly reported its gross annual receipts from the sale of steam within the City and correctly paid the required franchise fees. Further, the audit determined whether City departments complied with relevant requirements in administering and monitoring the steam franchise ordinance. The audit period was from January 1, 2007, through December 31, 2008.

To conduct the audit, the auditor reviewed the applicable provisions of the ordinance and the San Francisco Administrative Code, Chapter 11, which specifies requirements pertinent to franchises, interviewed NRG staff, and reviewed and tested applicable NRG reports and records. In addition, the auditor interviewed City staff, including staff of the SFPUC and the Controller's Budget and Analysis Division, and reviewed and analyzed applicable reports and records.

To determine whether NRG correctly reported its gross receipts, the auditor compared the amounts NRG reported to the City to the amounts recorded in its accounting records, and analyzed reported gross receipts to identify any unusual variances. The auditor tested on a sample basis whether NRG correctly billed its customers according to meter reading records and the relevant rate schedules filed with the California Public Utilities Commission.

To determine whether NRG correctly administered the asset list it uses to calculate the franchise fees due to the City, the auditor determined if the assets on the list complied with NRG's asset list policy. The auditor also identified and analyzed unusual items on the asset list, and verified that the amount for each of the assets recorded in 2007 and 2008 agreed to the amounts in NRG's accounting records.

This performance audit was conducted in accordance with generally accepted government auditing standards. These standards require planning and performing the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on

the audit objectives. We believe that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

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AUDIT RESULTS

NRG Correctly Reported Its Gross Receipts and Correctly Paid Its Franchise Fees to the City

NRG Energy Center San Francisco LLC (NRG) correctly reported \$41,285,959 in gross receipts and correctly paid to the City, on a timely basis, franchise fees of \$429,713 for 2007 and 2008. NRG correctly computed the gross annual receipts subject to the two percent franchise fee based on the ratio of its franchise assets to its total operating plant assets. NRG computed this ratio by using the historical costs of the asset values. The exhibit below shows the calculation of gross receipts subject to the City's franchise fee and demonstrates that NRG correctly paid the City \$429,713 in franchise fees for 2007 and 2008.

EXHIBIT Reported Gross Receipts and Franchise Fees Paid, 2007 and 2008

Year	Gross Receipts	Ratio of Franchise Assets to Total Investment in Operating Plant	Gross Receipts Subject to Franchise Fees	Franchise Fees Due*	Franchise Fees Paid	Under/Paid Franchise Fees
2007	\$20,201,447	51.458%	\$10,395,261	\$207,907	\$207,907	\$0
2008	21,084,512	52.599%	11,090,242	221,806	221,806	0
Total	\$41,285,959		\$21,485,503	\$429,713	\$429,713	\$0

*Note: Amount includes minor rounding differences.

Source: NRG's annual steam franchise statements.

The San Francisco Public Utilities Commission Did Not Submit the Required Steam Franchise Compliance Report to the Board of Supervisors

The San Francisco Public Utilities Commission (SFPUC) had not submitted to the Board of Supervisors the required Department Reports regarding NRG's steam franchise². When informed of this deficiency, the SFPUC filed the required report.

The San Francisco Administrative Code, Article V, Section 11.44 requires that the SFPUC submit to the Board of Supervisors a compliance report at least every two years regarding NRG's compliance with the requirements of the steam franchise. This report is to cover all aspects of franchise compliance except for those payment and

² The SFPUC has not submitted a compliance report since this requirement was included in the San Francisco Administrative Code, Article V, Section 11.44 on April 7, 2000.

reporting provisions covered by the Controller's audit report. Without the SFPUC's compliance report, the Board of Supervisors is not made aware of potential non-compliance by NRG with franchise terms.

After the auditor informed a SFPUC manager of the SFPUC's non-compliance with this requirement, the manager submitted to the Board of Supervisors a compliance report dated August 5, 2009. The report includes the required information, including:

- Whether there was a change of ownership.
- Whether the steam system complies with City requirements.
- Whether PUC identified any other provider of steam that did not have a franchise agreement.

Recommendation

The San Francisco Public Utilities Commission should:

1. Comply with the San Francisco Administrative Code requirement that it submit to the Board of Supervisors a Department Report regarding NRG's compliance with the requirements of the steam franchise at least every two years.

The Controller Did Not Thoroughly Check Franchise Fees Payments It Received

The Controller's Budget and Analysis Division (Budget Division) did not routinely check the accuracy of the franchise fees paid by NRG. The San Francisco Administrative Code, Section 11.22 requires franchisees to pay franchise fees to the Controller. Upon receipt of franchise fee payments, the Budget Division should take appropriate steps to ensure the amounts are correct. While Budget Division staff compares current payments to prior payments, the staff does not thoroughly check the accuracy of the franchise fees. As a result, errors in the franchise fee payments might go undetected. While the audit did not find any errors in NRG's annual franchise statements, the Budget Division could do more to assure that payments are correct, including:

- Checking calculations on the franchise statement.
- Analyzing significant variances from the prior year payment.
- Verifying the payment is timely.

Recommendations

The Controller's Budget and Analysis Division should:

2. Check the calculations on all franchise statements for accuracy, and document this work on the statements.
3. Establish appropriate thresholds for amounts that the current payment could reasonably vary from the prior payment, and perform further analysis if the payment variance exceeds the threshold. Budget Division staff should document this analysis.
4. Verify that the franchise statement and payment of the franchise fees are received before they are due, and indicate on the statement that this review was done. If the payment is late, the Budget Division should take appropriate action to assess late payment penalties specified in the San Francisco Administrative Code.

NRG Did Not Have a Written Policy for Administering the Asset List

NRG did not have a written policy for administering its asset list. NRG maintains an asset list to track its operating plant assets at historical cost, and to identify each asset as a franchise or non-franchise asset. NRG uses the ratio of franchise assets to operating plant assets to allocate its gross receipts and calculate the franchise fee that it pays to the City. A policy for administering the asset list is necessary to help ensure consistent recording of items that NRG adds to or removes from the list. If NRG inconsistently treats assets, it will not correctly calculate the amount of franchise fees it pays to the City. After the auditor informed NRG of this deficiency, NRG prepared a policy for administering its asset list dated June 23, 2009.

Recommendations

The San Francisco Public Utilities Commission should require NRG to:

5. Comply with NRG's policy for administering the asset list.
6. Periodically review and revise the policy, if necessary, to ensure it remains current.

NRG's Asset List
Includes Assets That Are
Not Well Described

Some assets on NRG's asset list are not well described. The auditor reviewed the asset list as of December 31, 2008, and found a number of assets that were not well described, including:

- Meters
- Fencing/gate
- General structures
- Rebuilds

The asset list is used to compute the franchise fees due to the City. The list needs to include adequate descriptions for all assets so that NRG can identify each asset and remove assets that are disposed.

Recommendation

The San Francisco Public Utilities Commission should:

7. Require NRG to review the asset list to ensure that each line item has a sufficient description.

NRG Did Not Sign Its Franchise Statement for 2008

NRG submitted the franchise statement for 2008 without signing or dating it. The Controller's Budget Division did not notice these deficiencies. The steam franchise ordinance, Section 5A, requires NRG to submit a "duly verified statement." The San Francisco Administrative Code, Section 11.34, requires the annual statement to be certified by an authorized and qualified person. NRG did not sign and date the 2008 statement until after the auditor informed NRG of this matter.

Recommendations

The San Francisco Public Utilities Commission should:

8. Remind NRG to ensure that the annual statement it submits is properly signed and dated.

The Controller's Budget and Analysis Division should:

9. Ensure that its staff verifies that NRG's franchise statements are signed and dated.

ATTACHMENT A: SFPUC'S RESPONSE



SAN FRANCISCO PUBLIC UTILITIES COMMISSION

POWER ENTERPRISE

1155 Market St., 4th Floor, San Francisco, CA 94103 • Tel (415) 554-0725 • Fax (415) 554-3280 • TTY (415) 554-3498



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COMMISSIONER

ED HARRINGTON
GENERAL MANAGER

October 16, 2009

Tonia Lediju, Director of Audits
Controller's Office
City Hall, Room 476
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Dear Ms. Lediju:

The San Francisco Public Utilities Commission (SFPUC) has reviewed the Franchise Fee Audit of NRG Energy Center San Francisco LLC (NRG), prepared by Controller's Office, City Services Auditor, for the period of January 1, 2007 through December 31, 2008.

The SFPUC concurs with the Audit findings and recommendations and will work with the Controller's Budget and Analysis Division and NRG, to ensure that any changes in NRG's assets, policies and/or procedures associated with the Franchise Fees are communicated and appropriately reconciled with revenue allocation methodology and payments.

Sincerely,

Camron Samii
San Francisco Public Utilities Commission
Manager, Strategic & Resource Planning, Power Enterprise

cc: Ben Carlick, Audit Manager
Barbara Hale, Assistant General Manager, Power Enterprise

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ATTACHMENT B: CONTROLLER'S RESPONSE



CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

Ben Rosenfield
Controller

Monique Zmuda
Deputy Controller

October 22, 2009

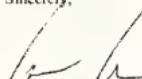
Tonia Lediju, Director of Audits
City Hall, Room 476
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Dear Ms. Lediju:

The Controller's Office Budget and Analysis Division has reviewed the Franchise Fee Audit of NRG Energy Center San Francisco LLC (NRG) prepared by the City Services Auditor for the period of January 1, 2007 through December 31, 2008.

We concur with the findings related to our Division. We have amended our task tracking calendar to include verification of timeliness and accuracy of steam franchise payments. Regarding recommendation #3 to establish thresholds and analyze each payment's variance from prior payments, we concur with the concept, but due to workload constraints, we propose to carry out this analysis as a component of our 6-month, 9-month and year-end analytical reports, and to work with NRG and PUC staff to explain such variances.

Sincerely,



Leo Levenson, Director
Budget and Analysis Division

Recommendation	Responsible Agency	Response
<p>1. Comply with the San Francisco Administrative Code requirement that it submit to the Board of Supervisors a Department Report regarding NRG's compliance with the requirements of the steam franchise at least every two years.</p>	<p>San Francisco Public Utilities Commission</p>	<p>The SFPUC complied with the San Francisco Administrative Code requirement for the 2007-2008 reporting period and will comply biennially as prescribed by the San Francisco Administrative Code.</p>
<p>2. Check the calculations on all franchise statements for accuracy, and document this work on the statements.</p>	<p>Controller's Budget and Analysis Division</p>	<p>We concur. We will check calculations on franchise statements for accuracy and document such work on the statements.</p>
<p>3. Establish appropriate thresholds for amounts that the current payment could reasonably vary from the prior payment, and perform further analysis if the payment variance exceeds the threshold. Budget Division staff should document this analysis.</p>	<p>Controller's Budget and Analysis Division</p>	<p>We concur with the overall concept but due to workload constraints we do not currently anticipate setting a specific analytical threshold or analysis documentation requirement for each payment, but rather to analyze the variance of franchise fees received to budget during our regular review efforts for our 6-month, 9-month and year-end analytical reports and work with NRG and PUC staff to explain such variances.</p>
<p>4. Verify that the franchise statement and payment of the franchise fees are received before they are due, and indicate on the statement that this review was done. If the payment is late, the Budget Division should take appropriate action to assess late payment penalties specified in the San Francisco Administrative Code.</p>	<p>Controller's Budget and Analysis Division</p>	<p>We concur and have amended our task tracking calendar to include the due date of the steam franchise payment and will take appropriate action to assess penalties.</p>

Recommendation	Responsible Agency	Response
5. Require NRG to comply with its policy for administering the asset list.	San Francisco Public Utilities Commission	The SFPU will work with NRG to ensure that NRG complies with its policy for administering their asset list and share the results with the Controller's Budget and Analysis Division
6. Require NRG to periodically review and revise the policy, if necessary, to ensure it remains current.	San Francisco Public Utilities Commission	The SFPU will work with NRG to ensure that NRG periodically reviews and revises their policy, if necessary, to ensure it remains current and communicate any issues that may affect the payment amount with the Controller's Budget and Analysis Division
7. Require NRG to review the asset list to ensure that each line item has a sufficient description.	San Francisco Public Utilities Commission	The SFPU will work with the Controller's Budget and Analysis Division and NRG to ensure that NRG's asset list contains adequate descriptions for all of their assets used to compute the franchise fees due to the City.
8. Remind NRG to ensure that the annual statement it submits is properly signed and dated.		The SFPU will work with NRG to ensure that NRG's annual statement it submits is properly signed and dated.
9. Ensure that its staff verifies that NRG's franchise statements are signed and dated.		We concur and have amended its task tracking calendar to include instructions to verify steam franchise statements are signed and dated.

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ATTACHMENT C: NRG'S RESPONSE



Energy Center
San Francisco

NRG Energy Center San Francisco LLC
54 Mint Street, Suite 200
San Francisco, CA 94103-1819

Phone 415 777 3415
Fax 415 777 3787

October 21, 2009

Tonia Lediju
Director of Audits
City and County of San Francisco
Office of the Controller
1 Dr. Carlton B. Goodlett Place, Rm 316
San Francisco, CA 94102-4694

We have reviewed the audit report and are pleased with the findings that we reported and paid our Franchise taxes correctly and there are no recommendations directly to us to improve our system.

We have read the recommendations to certain City departments concerning our internal systems and offer the following comments from our perspective that may help expedite implementation of these recommendations.

As to the idea of establishing a threshold for the amount of tax that reasonably should be collected and remitted, we are not sure such a figure or percentage could be established due to three major factors that affect the tax: the weather, the economy and the price of gas. The weather and economy directly affect usage. Charges to our customers are based on actual usage; the lower the usage, the lower the charge and thus the lower the tax collected and remitted. This year we were very fortunate to have the price of natural gas fall approximately 35%, and as this is a pass-through, our rate to our customers fell in accordance with this decrease. As the tax is based on the total charge, collections and remittances will be less than in previous years. As each of these factors is extremely difficult to predict, estimating the amount of tax to be collected is equally as difficult.

We look forward to working with the City representatives from the various departments on all the recommendations in order for future audits to be even smoother than this one.


Karel Sykora
General Manager



